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July 23, 2018

The Honorable Jocelyn G. Boyd
Chief Clerk/Administrator
The Public Service Commission of South Carolina
101 Executive Center Drive, Suite 100
Columbia, SC 29210

Re: Application of Duke Energy Carolinas, LLC and Duke Energy Progress, LLC for
an Accounting Order to Defer Certain Costs Related to Grid Reliability,
Resiliency and Modernization

Docket No. 2018-206-E

Dear Ms. Boyd:

Duke Energy Carolinas, LLC's ("DEC") and Duke Energy Progress, LLC ("DEP") (collectively, the "Companies") hereby file this letter with the Public Service Commission of South Carolina (the "Commission") in response to a filing made on July 12, 2018 in this docket by the South Carolina Office of Regulatory Staff (the "ORS"). In this matter, the Companies have asked for deferral of costs related to its grid modernization investments of approximately \$17 million (DEC) and \$7 million (DEP). Such deferrals have been considered, and upon similar filings, approved, for deferrals of material costs incurred until such time that such costs may be considered for inclusion in rates.¹ Inquiries as to whether the costs were prudently

¹ See *Petition of South Carolina Electric & Gas Company for Authorization to Defer Certain Charges to the Company's Financial Statements Resulting from the Impact of Recent Economic Developments on Pension Cost*, Docket No. 2009-36-E, Order No. 2009-81 (Feb. 17, 2009); *Petition for an Accounting Order to Defer Certain Environmental Compliance Costs at Unit 5 of the Cliffside Steam Station*, Docket No. 2010-392-E, Order No. 2011-80 (Feb. 1, 2011); *Petition of DEC for an Accounting Order to Defer Certain Capital and Operating Costs Incurred for the Buck Natural Gas Combined Cycle Generating Plant and the Bridgewater Hydro Generating Plant*, Docket No. 2012-57-E, Order No. 2012-208 (Apr. 3, 2012); *Petition of DEC for an Accounting Order to Defer the Incremental Costs Associated with Cliffside Steam Station Unit 6, Dan River Combined Cycle Generating Facility and the McGuire Nuclear Station Uprate Project*, Docket No. 2013-99-E, Order No. 2013-237 (Apr. 10, 2013);

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incurred or appropriate for recovery occur in rate cases, and nothing in the approval of the accounting treatment requested by the Companies lessens the level of inquiry or scrutiny that may surround such costs at the time they are sought for recovery.

In its July 12, 2018 filing, the ORS asks the Commission to schedule a hearing to determine if the Companies' request for a deferral of costs associated with the Companies' grid investments is appropriate in South Carolina. The ORS states the request should be granted because 1) the Companies did not quantify the amount of earnings erosion that would be experienced if the request was not approved and 2) the North Carolina Utilities Commission ("NCUC") did not approve DEC's request for deferral accounting treatment in North Carolina in its most recent general rate case. While the Companies certainly understand and appreciate the position of the ORS, a hearing on the Companies' application is unnecessary at this time, given the limited nature of the Companies' request and the amount of information already provided by the Companies in support of their application.

As a preliminary matter, the Companies have provided the amount of costs required to be deferred, approximately \$17 million for DEC and \$7 million for DEP, to avoid earnings erosion that would take place if the Companies' request were not approved. The expected earnings erosion, if the deferrals are not approved, is approximately 39 basis points for DEC and 45 basis points for DEP to the Companies' allowed Returns on Equity. The Companies note that the provision of an earnings erosion calculation or other such detailed information has not previously been a requirement of this Commission for the consideration of an accounting order request, and is generally not provided by the requesting utility.² The provision of such information and the

Joint Petition of DEC and DEP for an Accounting Order to Defer the Impact of Interest Rate Management Agreements, Docket No. 2015-95-E, Order No. 2015-222 (Apr. 24, 2015); *Joint Petition of DEC and DEP for an Accounting Order to Defer Certain Coal Ash Remediation Costs*, Docket No. 2016-196-E, Order No. 2016-490 (June 8, 2016); *Petition of DEC for an Accounting Order to Defer Certain Costs Related to Advanced Metering Infrastructure*, Docket No. 2016-240-E, Order No. 2016-489 (June 29, 2016); *In re: Petition of South Carolina Electric & Gas Company for Authorization to Defer Certain Tax and Related Costs Arising from Claims for Deductions and Credits*, Docket No. 2016-373-E, Order No. 2016-820 (Nov. 30, 2016).

² See *Petition of South Carolina Electric & Gas Company for Authorization to Defer Certain Charges to the Company's Financial Statements Resulting from the Impact of Recent Economic Developments on Pension Cost*, Docket No. 2009-36-E, Order No. 2009-81 (Feb. 17, 2009); *Petition of DEC for an Accounting Order to Defer Certain Capital and Operating Costs Incurred for the Buck Natural Gas Combined Cycle Generating Plant and the Bridgewater Hydro Generating Plant*, Docket No. 2012-57-E, Order No. 2012-208 (Apr. 3, 2012); *Joint Petition of DEC and DEP for an Accounting Order to Defer the Impact of Interest Rate Management Agreements*, Docket No. 2015-95-E, Order No. 2015-222 (Apr. 24, 2015); *Joint Petition of DEC and DEP for an Accounting Order to Defer Certain Coal Ash Remediation Costs*, Docket No. 2016-196-E, Order No. 2016-490 (June 8, 2016); *Petition of DEC*

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establishment of a hearing are not necessary because, consistent with S.C. Code Ann. § 58-27-870(F), Commission action on such accounting requests does not require a determination of the rate structure or rate of return, nor does it have any impact on rates. Moreover, as the Commission has previously acknowledged, Commission action on accounting requests are not precedential and does not prejudice the right of any party to contest the accounting treatment in the utility's future rate proceeding or other earnings-related proceeding.³ As such, the Companies believe that it would be inconsistent with the Commission's established practice and policy to require a hearing on a request for deferral accounting in this case, and the Companies are aware of no prior accounting order request being set for hearing by this Commission. The Companies' request for an accounting order, to defer in a regulatory asset costs related to the grid investments being made for reliability, resiliency and modernization until each Company's next general rate case, does not involve a change to the Companies' current retail rates or prices, or require any change in any Commission rule, regulation or policy. Additionally, as in prior cases, the issuance of the requested deferral accounting order would not prejudice the right of any party to address the prudence of these costs in the Companies' next general rate cases. Therefore, to conduct a hearing now to determine whether the Companies' grid investments should be made is premature and could confuse the standard of prudence for cost recovery later when the Companies are actually seeking recovery for the investments.

Given that the burden of prudence for grid investments and ultimate questions of cost recovery are procedurally grounded in a future rate proceedings, the Companies generally agree with the ORS that information about the initiative is critical to understanding the benefits to South Carolina customers of these investments—that is precisely why the Companies have been very transparent in their plans and actions, including the volume of detail included in the

for an Accounting Order to Defer Certain Costs Related to Advanced Metering Infrastructure, Docket No. 2016-240-E, Order No. 2016-489 (June 29, 2016); *In re: Petition of South Carolina Electric & Gas Company for Authorization to Defer Certain Tax and Related Costs Arising from Claims for Deductions and Credits*, Docket No. 2016-373-E, Order No. 2016-820 (Nov. 30, 2016).

³ *In re Application of South Carolina Electric & Gas Company for Approval of Accelerated Capital Recovery of Generating Assets*; Docket No. 1999-389-E, Order No. 1999-655 (Sept. 16, 1999); *In re Application of Carolina Power & Light Company for Approval of Accelerated Cost Recovery of its Nuclear Generating Assets*, Docket No. 1999-29-E, Order No. 1999-75 (Jan. 29, 1999); *In re Carolina Power & Light Co.*, Docket No. 2003-84-E, Order No. 2003-283 (Apr. 28, 2003); *In re Petition of Progress Energy Carolinas, Inc. to Defer and Amortize Storm Damage Expenses*, Docket No. 2004-55-E, Order no. 2004-367 (Sept. 27, 2004).

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application filed by the Companies as well as the appropriate *ex parte* briefings to the Commission and documents provided therein, including an in depth technical whitepaper and economic analysis, which the Companies have attached to this filing.⁴ The Companies are also engaging in substantive stakeholder engagement, including a technical workshop planned for mid-August.

As the ORS referenced in its July 12, 2018 filing, the NCUC recently denied DEC's request for deferral accounting treatment for Power/Forward costs within the context of a rate case, however that case is distinguishable. In particular, the primary reasons for the NCUC's decision to deny deferral accounting was that DEC did not provide details about specific projects to be completed under the Power/Forward initiative nor showed how the effect of not deferring Power/Forward costs would cause economic harm to DEC. The NCUC also made it clear in its order that DEC may seek deferral at a later time outside of the test year to preserve the Company's opportunity to recover costs associated with Power/Forward, provided it can meet the test of economic harm and/or is considered an "extraordinary expenditure." The NCUC also encouraged the Companies' efforts to strengthen and modernize its grid and, to that effect, committed to expeditiously considering such a future request by DEC.⁵

By contrast, the Companies' application in the instant proceeding provide detailed information about the work that will be performed, including the number of counties and, in most instances, the number of projects that will be completed under each category of the grid modernization initiative per year. The Companies were also very clear in their applications about the economic harm they would experience if deferral accounting is not authorized by the Commission. Specifically, without the accounting treatment requested by the Companies, the costs incurred and being incurred for the projects will negatively impact the Companies' financials on a project by project basis, and unlike capital projects of similar financial magnitude, the Companies will not recover its time value of money in the form of allowance for funds used during construction ("AFUDC"). Instead, the Companies' earnings will be negatively impacted every time an individual grid project is completed as it creates an instant degradation to the

⁴ *DEC and DEP's Request for an Allowable Ex Parte Briefing Regarding Power/Forward Initiative*, ND-2018-15-E (May 23, 2018).

⁵ *Order Accepting Stipulation, Deciding Contested Issues, and Requiring Revenue Reduction*, NCUC Docket No. E-7 *et al.*, at 148 (June 22, 2018).

Companies' financials, which may likely impede the deployment of these investments for the benefit of customers. The requested deferral will allow the Companies to bridge this timing gap until the Companies' next rate case while completing work that will enable the customer benefits that the work in process will provide.

Further, the incremental annual depreciation, amortization and operation and maintenance expense that the Companies will incur as grid investments are being made are not currently included within the Companies' existing base rates. Therefore, it is not possible for the Companies to "match" this expense with revenue to be collected. With such a mismatch of expense to revenue, this event is a fundamental departure from the matching principle under Generally Accepted Accounting Principles ("GAAP"). Accordingly, absent the deferral, it is clear the Companies will face earnings degradation from the increased expenses arising from the current and near term planned grid investments, and in fact, may not be able to make the investments without deferral of the costs until such time they can be recovered.

In addition, as explained in the Companies' application, the Companies have committed in the Tax Reform Docket to defer as a regulatory liability (1) all excess accumulated deferred income tax balances created in 2017 by the TCJA Act and (2) the estimated difference between customer revenues actually billed and what would have been billed taking into effect the reduced corporate tax rate beginning January 1, 2018, until the Commission determines the timing and nature of returning such benefits to retail customers. As the Companies defer revenues, it is important to defer significant costs like the grid investments being made for reliability, resiliency and modernization such that total impact of the changes affecting the Company's business can be evaluated in future rate proceedings.

As detailed in the Companies' application, the Companies' grid investments will address the present and future needs of the grid over the next decade, and beyond, for the benefit of its customers in South Carolina. The investments will harden the system against storms and outages, further protect it against cyberattacks and physical threats, help expand renewable energy, generate jobs and stimulate economic growth. It will also give 740,000 customers in the State more information to manage their energy use. The types of investments the Companies intend to make will work together to deliver customers solutions that are both operationally and cost effective. In fact, Duke Energy's similar initiatives have been received positively in its

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other jurisdictions. For example, grid investment work has been underway for over a year in Florida and Indiana, with incremental rate adjustment mechanisms already in place.⁶

For these reasons, the Companies request that the Commission grant the relief that the Companies seek without conducting a hearing, as allowed by law and consistent with prior practice, and deny the July 12, 2018 request filed by the ORS. However, in the event the Commission finds that a hearing is warranted, the Company submits that the hearing should follow a pre-filing schedule for comments made by the parties, and should be limited to the merits of the specific request herein, and limited to oral argument on the legal parameters of the Companies' request.

Yours truly,

A handwritten signature in cursive script that reads "Heather Shirley Smith".

Heather Shirley Smith

Enclosures

cc: Parties of Record

⁶ *In re Duke Energy Indiana, Inc.*, Indiana Utility Regulatory Commission Cause No. 44720 (June 29, 2016); *Application For Limited Proceeding to Approve 2017 Second Revised and Restated Settlement Agreement, including Certain Rate Adjustments*; Florida Public Service Commission Docket No. 20170183-E1, Tr. at 61-67 (Oct. 25, 2017).